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SENSITIVE

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1B. 2004 ISTANBUL 1558

11. (SBU) Summary: In a move that marked the first official step forward towards realization of its long-rumored desire to buy Yapi Kredi Bank, Unicredito-Koc Holding on January 17 announced that it had signed an agreement with the bank's dominant shareholder, the controversial Cukurova Group, for exclusive negotiating rights. The statement stressed that the agreement was for the start of negotiations, rather than their conclusion, implying that agreement on price will likely await conclusion of the partnership's due diligence on Yapi Kredi. That process may take time, as in addition to the 2 billion USD debt owed by the Cukurova Group to the bank, the bank's balance sheet includes other assets that many believe will need to be revalued. Overall, however, markets and Istanbul analysts have reacted positively in the hope that the long-standing uncertainty surrounding one of Turkey's flagship banks can be brought to closure quickly.
End Summary.

12. (SBU) After a weekend in which rumors (stemming in part from government sources) were rife that the Unicredito-Koc Holding financial services partnership had reached agreement to buy Cukurova Holding's 45 percent stake in Yapi Kredi Bank for 900 million USD, clarification came on Monday with announcement by both principals that agreement had been reached on an exclusivity agreement allowing for the start of negotiations between the two parties. Both sides stressed that this was the start rather than the end of the process, and said that due diligence on the bank would begin immediately.

13. (SBU) Though apparently premature, the 900 million USD figure may end up not being far off the mark, as it implies a 2 billion USD valuation for the bank, close to the target valuation assigned it by most Istanbul brokerages. It is, however, below the bank's current market capitalization, which has increased 40 percent since the end of October 2004 to 2.5 billion USD, as foreigners in particular have made Yapi Kredi one of the most traded stocks on the Istanbul Stock Exchange (ISE). Key complicating factors for the bank's valuation are the outstanding 2 billion USD receivable owed it by the Cukurova Group, as well as overvaluation of a number of other assets on the bank's books. These include 400 million USD the bank has booked as receivables from a disputed hazelnut tax collection (few expect it to see any where near this amount), and a half share in A-Tel telecommunications, which the bank also generously values at 400 million USD, but which analysts doubt is worth more than a tenth of that. With the stock market's rise over the past two years increasing the value of the Turkcell shares held by Yapi Kredi as collateral for the Cukurova loan to nearly 1.7 billion USD, the rumored 900 million USD sale price would appear to show that at least some preliminary discussion has taken place about how to compensate for these "holes" in the bank's balance sheet.

14. (SBU) Pressure has been increasing in recent months on the Cukurova Group, following the well-publicized failure at the end of the year of the revised payment plan that would have permitted it to settle its debt to Yapi Kredi and to the Savings Deposit Insurance Fund (to which it also owes 2 billion USD for the takeover of the group's second bank--Pamukbank). That deal would have ensured that the group retained control of its other prize asset of Turkey's largest mobile phone operator, Turkcell. The failure of the group to come through with promised financing severely damaged its credibility. Just last week, Bank Regulatory Agency (BRSA) Chairman Tevfik Bilgin warned that the Cukurova Group was "walking on a thin layer of ice," and that while the agency would try to help it get across, "if the ice cracks, it is the group that will get wet." The January 17 announcement precedes by two weeks the group's deadline to sell the bank by itself, under its agreement with regulators. After January 31, the group and BRSA will jointly seek a buyer, and if that effort is unsuccessful by October 31, then BRSA assumes sole responsibility for the sale. The agreement with regulators' built-in pressure on Cukurova to find a buyer has

apparently worked, and probably explains the joint announcement with Koc-Unicredito.

15. (SBU) Given Yapi Kredi's size and role as a pioneering consumer bank in Turkey, the uncertainty surrounding it has cast a pall over the entire banking sector for some time. Nonetheless, bank management has worked intensely over the past two years to preserve the franchise, and while there has been some slippage in the bank's share of the loan market, recent statistics reflect the bank's staying power. In the third quarter of 2004 (the latest period for which figures are available), while the bank's net profit fell far below market expectations because of an adjustment in deferred tax assets, bottom line figures for interest income and net fees and commission were in line with market predictions. The bank's asset size increased 4.9 percent over the previous quarter (7.4 percent from a year earlier), with increases in deposits making up a third of that total. Though its share has stagnated, Yapi Kredi, Turkey's oldest private bank, remains the market leader in credit cards, and booked continued growth in loan volumes (up to 6.5 billion USD in September from 5.8 billion USD at the end of 2003).

16. (SBU) Notwithstanding this success, bank insiders have told us frequently in recent months that the continued uncertainty is hurting their efforts to maintain the bank's market position. Especially, since last March, when the BRSAs replaced the bank's board with its own candidates, they describe a culture that has grown increasingly cautious and risk averse. The resultant unwillingness to undertake major promotions or campaigns ultimately led the bank's CEO Naci Sigin to tender his resignation in September. Former Bank Chairman Rona Yircali described this to us as a serious mistake by bank management, though he conceded that the damage was minimized by the new board's decision to select the acting CEO from inside the bank (Vice President for Financial Analysis and Credit Risk Management Rena Yolalan). Despite a news campaign to the contrary, bank executives note that increasing numbers of personnel have left in recent months, and that those who remain are having difficulty maintaining their motivation. The risk, one senior executive told us, is that if the sale takes a year or two, there may not be a franchise remaining to be sold.

17. (SBU) Comment: Monday's announcement holds out the promise that this extended bloodletting can be avoided and that instead Yapi Kredi may find itself moving swiftly into the hands of one of the bluest of Turkey's blue chips. If so, the outcome may turn out to be a win for all concerned: for Koc and Unicredito, which have openly aspired to raise their modest profile in the financial world in Turkey (Kocbank, which will likely remain a separate franchise, is less than a third the size of Yapi, with only a small share of Turkey's consumer market), for the BRSAs, which has sought to avoid a protracted struggle with the Cukurova Group while still ensuring that the bank leaves their control, and for the Cukurova Group as well, which appears to have accepted the fact that it cannot preserve all of its current assets, and is now focused on trying to maintain its hold on Turkcell. The Unicredito-Koc gambit, following the recent deal between BNP Paribas and TEB, and rumored talks between other small Turkish banks and international partners, also marks another step towards increased international presence in Turkish banking, giving credence to BRSAs chief Bilgin's prediction that foreign ownership in the sector may increase from 3 to 15 percent by the end of the year. End comment.

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